CHEYNE'S POST-BREXIT REACTION

Following the UK vote to leave the EU, the credit fund manager is finding opportunities in the London market to invest in diverse market sectors, says partner and head of real estate business Ravi Stickney.

There has been no real distress in the London market post-Brexit, beyond a handful of sales from open-ended retail funds. That is the widely held perception, anyway.

That is not how Cheyne Capital views matters, and it certainly appears this is not true of the UK lending world. In the aftermath of the UK vote to leave the EU, the real estate credit fund manager is already finding opportunities to put its money to work in a market where it has not found many deals in the last few years.

"Well, I wouldn't call it distress, but there is definitely stress," says Ravi Stickney, partner and head of Cheyne's real estate business.

Well-oiled machine

Cheyne is something of a machine in the world of real estate debt, low-key but functioning brilliantly. The real estate arm of the business was set up in 2008 to buy "structured credit", principally commercial and residential mortgage-backed securities, which were trading at discounts as a result of the credit crunch.

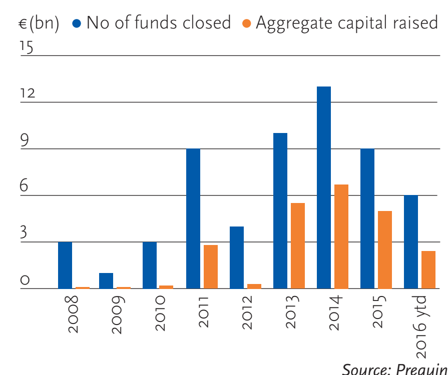
It made money and a name for itself doing this through the depths of the downturn, and pulled off some high-profile and profitable deals. In 2012 it bought the junior debt secured against the 31,587 sq m Woolgate Exchange office building in the City of London alongside TPG, which allowed it to take control of the property for £265m (€309m). Two years later it sold the office for £325m.

In 2011 it launched its first fund able to undertake direct lending, Cheyne Real Estate Credit Holdings I, which raised $625m of equity. Like its offspring, it could buy bonds, provide senior debt, mezzanine debt, whole loans, preferred equity or buy into special situations – the full spectrum of real estate credit.

The second fund was a smaller vehicle that was essentially a separate account for a single client, and in 2014 it launched the third fund. That held a final close earlier this year raising $760m of equity, and is already fully invested.

Europe-focused real estate debt fundraising

Capital for debt funds peaked in 2014



Source: Prequin

With that in mind, it is already raising new capital, but this time for two vehicles, not one. Cheyne Real Estate Credit Holdings 4 will only undertake direct lending, mainly senior lending with some mezzanine positions.

Cheyne Real Estate Credit Holdings 5, on the other hand, will be more targeted at special situations – fund-world speak for pockets of stress – and undervalued bonds. It is looking to raise £800m of equity across the two strategies. Fund four will have a target return of around 8%-10%, lower than the 10%-12% returned by previous funds. Fund five will have a higher return target of the "mid-teens".

Stickney is already seeing plenty of the special situations that the fifth fund will target as a result of Brexit, and says the UK vote, while not the defining factor in its strategy, is causing it to alter its strategy.

"In a stable market with an upward trend, we do more mezzanine lending, but after Brexit, the sweet spot has been senior lending, and buying CMBS. We are seeing Brexit present plenty of special situations already, and that is a big part of what we do.

"Brexit has already impacted asset values, they were falling before and lending is being even more curtailed. Immediately we are already seeing some stressed recapitalisations, borrowers coming to us with great assets who are under stress because recapitalising has become more difficult.

"The chief area – no surprise – is London residential. Prices were declining and the financing base was shrinking even before Brexit. Prime London residential is not an area we've funded for some time, but we're seeing value there again.

"And there has also been an impact on City of London offices. Lenders are nervous about values so there is a demand for our capital."

Stickney says Cheyne has also been buying CMBS – Woolgate redux to a certain degree. "We're doing CMBS deals as we have done in the past. Values are falling for City offices and we're picking up controlling pieces like we did in the 2009-12 period. We buy bonds that are at an attractive level and have control rights that enable us to influence the outcome. We have a seat at the table and we look to work towards a consensual solution."

Capital value

On the whole, Stickney says that these investments are a sign of confidence in London rather than an indication that the market will fall precipitously: "We were comfortable underwriting London offices in 2009, post-credit crunch, when we bought bonds secured against a number of high-profile London office assets, and we're comfortable underwriting deals post-Brexit."

As for the general strategy of Cheyne and its funds, 95% of its portfolio is in the UK and Germany – always has been, always will be, Stickney says.

In terms of assets classes, in its direct lending activities it has gravitated towards sectors that it deems "non-cyclical" such as health care, student accommodation and private-rented sector deals in the UK and multi-family residential and convenience-led retail in Germany.

"The cyclical asset classes are obvious,

FIVE LARGEST EUROPE-FOCUSED REAL ESTATE DEBT FUNDS TO CLOSE 2015-16 (YTD)

Top five funds raise more than €5bn for lending to European real estate

Fund	Manager	Final size (€m)	Year of close	Location focus
CRE Senior 9	Axa Investment Managers – real assets	2920	2015	Europe
AgFe Real Estate Senior Debt Floating Rate Fund	AgFe	1192.26	2016	UK
Cheyne Real Estate Credit Holdings III	Cheyne Capital Management	770 USD	2016	Europe, Germany, UK
German Senior Debt Fund	Deutsche Asset & Wealth Management	500	2015	Germany
Renshaw Bay Real Estate Finance Fund	Renshaw Bay	481.17	2015	Benelux, France, Germany, Norway, Sweden, UK

Source: Preqin

FIVE LARGEST EUROPE-FOCUSED REAL ESTATE DEBT FUNDS IN MARKET

Broad range of target destinations and strategies

Fund	Manager	Target size (€m)	Fund status	Location focus
Kildare European Partners II	Kildare Partners	1809.4	First close	Europe
Pramerica Real Estate Capital VI	PGIM Real Estate	1204.02	First close	Europe, Germany, Ireland, UK, west Europe
ICG-Longbow UK Real Estate Debt Investments IV	ICG-Longbow	1057.12	Second close	UK
Senior European Loan Fund 2	AEW Europe	750	First close	France, Germany, Italy, Spain, UK, west Europe
UK Enhanced Debt Fund	TH Real Estate	704.74	First close	UK

Source: Preqin

like offices or high street retail," he says. "In the UK we bought into the care home sector, buying bonds after the collapse of Southern Cross in 2011. As the sector deleveraged and became more institutional, values in the sector increased. Now the values are more stable and the income is very non-cyclical. There are a lot of opportunities for owners to buy poor-quality stock and improve it and improve income. We think there will be stable demand for many years to come.

"In PRS we have done our first couple of deals, which have been mezzanine deals, and we are looking to expand our exposure in terms of both senior and mezz.

"If you look at the demographics, we've been in the market long enough to be able to track the demand-and-supply curve. We're not talking about Mayfair, we're talking about places with affordable rents on the outskirts of London. We think there is long-term demand there and limited supply, and we like the way that the US operating model is being transported to the UK."

In Germany Cheyne has principally been lending to the multi-family residential sector, about which Stickney says: "It doesn't matter what happens, Brexit, US elections, the demand there is constant."

But it is also moving into lending against convenience-led retail deals. As with many of its strategies, it explored the sector through purchasing CMBS and participating in a workout deal, and is now moving into direct lending.

"You have a lot of these centres which specialise in non-discretionary, affordable retail, where 50,000 families will go to buy affordable food, clothing and healthcare. But they have been neglected because there has been no capital expenditure on them.

"But we think there is good long-term sustainable demand, so we are happy to lend to good sponsors buying these assets, and we want to increase our exposure to this sector."

CMBS lag

Cheyne has clearly made money buying CMBS, but Stickney also has fascinating views on why the sector has not been able to take flight after the credit crunch in terms of new issuance, in spite of the fact that investors seem hungry for real estate exposure in other forms.

"For European real estate to finance itself efficiently it needs a functioning CMBS market," he says.

"For core and core-plus real estate it is an efficient way to transmit risk. But European regulators have curtailed the CMBS market, and the regulations they have imposed means it has struggled to get off the ground.

"We have deployed a lot of capital and worked alongside banks to help them issue CMBS. One of our earliest deals was Annington Finance PIK bonds, and we have replicated that success and working relationship on many other deals that followed. Working alongside banks to bring forward CMBS will form a large part of our business going forward.

"Institutional investors are being penalised with capital charges for owning CMBS in Europe, and that needs to change."

One thing Stickney says strikes an odd note, is that his business has not really changed since 2008. Given how different the lending world is today compared to 2008, that seems impossible. But Stickney makes strong a argument. It is not heading to exotic territories or lending against unzoned land to make the same returns as it has always made.

And with a little bit of stress coming back into the market, things will get a bit more interesting from here on in.